THE SEGREGATION OF THE SECURITIES BUSINESS FROM THE BANKING BUSINESS UNDER JAPANESE LAW

Japan's Securities and Exchange Law of 1948 1/ contains provisions concerning the segregation of the securities business from the banking business, based on the model of the U.S. Banking Act of 1933 (the Glass-Steagall Act). The Japanese Securities and Exchange Law is a modified version of the Securities Act of 1933 and the Securities Exchange Act of 1934 of the United States. Under article 65, paragraph 1, of the 1948 Law, banks, trust companies, and such other financial institutions as may be designated by a Cabinet Order (hereinafter all referred to as financial institutions, unless specifically designated otherwise) are prohibited from engaging in the securities business as defined in the Law.

According to article 2, paragraph 8, of the Securities and Exchange Law, a securities business is defined as one that (1) buys and sells securities; (2) acts as an intermediary, broker, or agent in regard to the buying and selling of securities; (3) acts as broker, agent, or proxy in regard to the entrustment of transactions on a securities market; (4) underwrites securities; (5) effects the secondary distribution of securities; and (6) handles the offering or secondary distribution of securities.

Financial institutions are allowed to engage in securities transactions in the following four cases: (1) where a bank engages in the trading

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1/ Law No. 25, Apr. 13, 1948, as last amended by Law No. 71, June 21, 1985.

of securities upon the written order and for the account of a customer; (2) where a financial institution engages in the trading of securities for investment purposes pursuant to other laws; (3) where a financial institution engages in the trading of securities pursuant to a trust contract and for the account of the trustor (art. 65, para. 1, proviso); and (4) where a financial institution engages in the securities business pertaining to government bonds, municipal bonds, and guaranteed government bonds (hereinafter referred to as public bonds) (art. 65, para. 2).

Under the Law of Foreign Securities Firms of 1971, 2/ which enabled foreign securities firms to engage in the securities business in Japan, foreign securities firms are, with certain exceptions, prohibited from engaging in the banking business. It has been reported that at present many Japanese banks are engaged in the securities business in foreign countries, through either wholly owned subsidiaries or a controlling stock interest in foreign securities firms. 3/

The difference between the U.S. securities law and the Japanese law is described in the book Japanese Securities Regulation:

> Although the United States also requires the separation of banking securities activities, it does so for different reasons. The United States bases its policy on the protection of bank depositors and maintenance of public confidence in the commercial banking system, while the Japanese policy emphasizes the healthy development of the securities business by making it independent. 4/

2/ Law No. 5, Mar. 3, 1971, as last amended by Law No. 78, Dec. 2, 1983.

3/ Louis Loss, Makoto Yazawa, and Barbara Banoff, eds., Japanese Securities Regulation 76 (Tokyo, University of Tokyo Press, 1983).

4/ Id.

As noted earlier, the Securities and Exchange Law spells out four exemptions from the general prohibition, but the original Banking Law enacted in 1971 contained no provision permitting financial institutions to engage in the securities business. This situation brought about a controversy between the securities industry and the banking industry regarding the interpretation of the provisions of the two laws, especially with respect to public bonds. The Banking Law was revised in 1981 and explicit provisions were added which permit financial institutions to engage in the securities business for the following transactions:

> (1) Sales of securities for investment purposes or upon the written order and for the account of a customer;
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> (2) Underwriting of public bonds or handling of subscriptions to the public bonds so underwritten;
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> (3) Underwriting, dealing, selling, and other types of securities business concerning the public bonds to the extent that such business shall not impede banking business operations (art. 10, para. 2; art. 11).

In the same year, the Securities and Exchange Law was revised to include a new article requiring financial institutions to obtain validation from the Minister of Finance in order to engage in the securities business relating to public bonds (art. 65-2). Financial institutions have also been made subject to several standard provisions of the Securities and Exchange Law, such as the prohibition against soliciting purchase or sale of securities by providing a prediction of a rise or drop in price or by promising to bear all or part of the loss incurred as a result of the transactions (art. 65-3). Furthermore, securities firms that engage in other activities, such as dealing in foreign negotiable certificates of deposit or commercial

paper, have been legalized (art. 43). These measures are intended to provide equal treatment for both industries.

Prepared by Dr. Sung Yoon Cho
Acting Chief
Far Eastern Law Division SC
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